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SUBJECT: CATERPILLAR GLOOMY AS COMMODITIES DOWNTURN
CONTINUES

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Classified By: Justin Kolbeck, Pol/Econ Officer, reasons 1.4 b, d

Summary

1. (C/NF) Tamera Nelson, Caterpillar's Managing Director for Melbourne and Tasmania, expects to lay off nearly one third of her workforce this year (strictly protect) due to sagging commodities prices and complex new industrial relations legislation. As the commodities slump continues to drag on the wider Australian economy, most business and government leaders are betting that a turnaround will occur sooner than later. End Summary.

Tough Times Ahead

2. (C/NF) U.S. citizen Tamera Nelson, Caterpillar's Managing Director for Melbourne and Tasmania, told pol/econoff on January 13 that she expects a tough 2009 despite strong 2007 and 2008 results. Low commodities prices and slowing mining operations throughout Australia have translated into reduced demand for Caterpillar's products. Nelson believes that she will have to lay off at least 350 of Caterpillar's 1,120 employees in Australia in 2009 (strictly protect). According to Nelson, this is due in part to new industrial relations legislation brought in by the Rudd government in November 2008 (reftel). Ambiguity in the new laws, she said, will likely force her to lay employees off rather than reduce hours or institute a temporary halt in plant operations. Caterpillar's legal team is still sifting through the new laws, but Nelson was visibly frustrated by the uncertainty caused by the new legislation.

3. (C) Tougher industrial relations laws are also making Caterpillar's Australian operations less competitive, Nelson said. The company is not due to renegotiate its payroll contracts until 2011. Automatic 4.3 percent pay raises are built into these contracts. Nelson fears that slumping demand for Caterpillar's products combined with mandated raises will make Australia less competitive vis-a-vis the company's other off-shore centers in South Africa, China, Indonesia and Mexico. Nelson stated that a weaker Australian dollar has not helped Australian operations because her organization is required to import a significant number of component products.

Boom to Bust

4. (C) Nelson said that she and other senior management at Caterpillar were "shocked" at how quickly the commodities "super boom" turned south. Caterpillar was not prepared for the reversal which took place within 30 days, and Nelson said

that she was "uncertain" when the bust would turn around. She also expressed concern over recent Chinese demands to negotiate coal and iron ore contracts four times per year. (Comment: These contracts are presently negotiated annually and industry leaders fear that frequent renegotiation could lead to lower average prices. Economists believe that contract renewals, which are due in April 2009 could lead to a halving of prices. This could slice as much as A\$30 billion (US\$20 billion) off of Australia's export receipts, and 2.5 percent off real national income -nearly triple the Rudd government's recent stimulus package. End comment.)

15. (C) Nelson, who was previously posted in China, said that she was surprised at how quickly Beijing could turn off (or on) demand for a product. Without going into detail, she noted that orders for a particular product dried up entirely within 24 hours after the Chinese government announced that it was pulling support for an infrastructure project. Nelson hoped that resumption in Chinese demand would resume as quickly as it has fallen off.

Unwelcoming Shores

16. (C/NF) Nelson, based in the northern Tasmanian city of Burnie for two years, said that doing business in Tasmania has been a "challenge." She opened the meeting by describing a month-long debacle that erupted in Tasmania when she decided to change the company's annual "Xmas" party to a "holiday" party. Angry Tasmanians bombarded her with complaints and Nelson even expressed a concern for her safety during the holiday season. She said that she would not ride

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her bike in Burnie out of a fear of "being run off the road." The reaction, she said, was due to the isolated and "provincial" nature of northern Tasmanians and stated that she was not prepared for the resistance she would encounter in Australia. Caterpillar is the first or second largest employer in Tasmania and Nelson indicated that the reaction to lay-offs would be much more negative than anything she had confronted so far.

Comment

17. (C) Caterpillar's challenges are similar to those faced by most companies in the Australian mining business. Mining giant Rio Tinto announced on January 14 that it would save A\$340 million (US\$229 million) by suspending underground development at its Northparkes copper/gold mine in New South Wales and by shelving a plan to develop driverless trains in Western Australia. OZ Metals, which is battling a mountain of debt, announced on the same day that it would suspend operations at its Scuddles mine in Western Australia. Caterpillar's finance arm also faces new difficulties caused by fall-out from the global financial crisis, telling Embassy Canberra it finds itself less competitive since the Rudd Government extended wholesale funding guarantees to authorized deposit-taking institutions (ADIs). Now Caterpillar finance is considering converting to ADI status. Although the company clearly faces near-term challenges, Nelson was relatively upbeat regarding the company's longer term presence in Australia.

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